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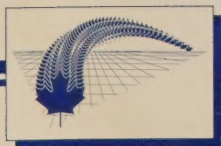
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Air Services

*A Staff Report to the
National Transportation Act
Review Commission*

May 1992



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AIR SERVICES

EXECUTIVE SUMMARY

Section 266 (3) of the *National Transportation Act, 1987* (NTA, 1987) requires the Comprehensive Review to address two aspects of air services. These are:

- "the impact of this Act on air service in the various regions of Canada, particularly on routes having low traffic volumes" ; and
- "the advisability of retaining or modifying the special economic regulation applicable to northern and remote air services."

The NTA, 1987 removed most economic regulation of air transportation in southern Canada and changed the regulations in northern and remote regions of Canada.

Following the introduction of the new legislation, the economy entered a recession which reduced the demand for air services and has influenced the level of service provided by air carriers since the third quarter of 1989. In comparison to the years before 1988, service to travellers and shippers has improved despite a drop in demand for flights during the recession. More flights and seats are offered in all markets than during 1983 to 1987, when the economy was strong.

The two large carriers are suffering short-term difficulties due to reduced demand on high volume routes and long haul routes and have had to deal with excess capacity through layoffs, reductions in the number of flights and the transfer of services to regional affiliate networks.

Travellers and shippers have access to more flights and more frequent service than before 1988 because regional affiliate networks have expanded, acquiring routes previously served by the larger carriers, and expanding into previously under-served local markets. This has been effective in linking northern and remote communities to the networks of major carriers.

Average air fares paid by travellers have only marginally increased since 1987, due to the increased use of discount fares. This is consistent with average revenues (yield) which have decreased since 1987 and is now stable.

Under the NTA, 1987, some regulatory control, (licensing and complaints against unreasonable fares), over northern and remote air services was retained because air service markets are fragile in these regions. Since 1988, 209 objections to licence applications have been filed and the

AIR SERVICES

Agency has denied licences in two cases. There have been five complaints against fares and in each case the Agency found the fares to be reasonable. Surveys of travellers carried out under the Annual Reviews have identified support for the retention of regulatory controls in northern and remote regions.

INTRODUCTION

Subsection 266 (3) of the *National Transportation Act, 1987 (NTA, 1987)* requires that the Comprehensive Review address two aspects of air services. These are:

- "the impact of this Act on air service in the various regions of Canada, particularly on routes having low traffic volumes" ; and
- "the advisability of retaining or modifying the special economic regulation applicable to northern and remote air services."

The *NTA, 1987* was designed to reduce regulation and encourage reliance on market forces to improve service to travellers and shippers. The *NTA, 1987* removed most economic regulation of air transportation in southern Canada and changed the regulations in northern and remote regions of Canada.

In southern Canada, before the *NTA, 1987*, market entry controls required applicants to show that proposed services met public necessity and convenience criteria. Now, carriers must be Canadian and need only a fitness test (i.e., safety and insurance standards). Before, to reduce or discontinue a service, carriers had to get approval. Now, the carrier need only give 120 days notice. Carriers no longer need to file fares and rates, merely publish them. The *NTA, 1987* allows the National Transportation Agency to control increases in fares on monopoly routes in southern Canada.

The *NTA, 1987* recognized the special role of northern and remote air transport. In northern and remote services, carriers must also prove themselves fit. Additionally, a person or company can request that the Agency refuse to grant the licence, but they must prove that the service would harm the public. On northern and remote routes, the public can complain to the Agency about a rise in fares; if the Agency finds these fares unreasonable, it may reduce them. In the north, the scheduled, charter and specialty licence categories remain, and the Agency may restrict licences to specific routes and types of aircraft.

International air service provisions remained the same except for some administrative streamlining.

This analysis, by Agency staff, examines the changes in air services across Canada since 1988, and reports on how the special regulatory controls are working on northern and remote air services.

SERVICE

This section reviews the changes to air services and fares since the new law was introduced. It then describes the changes in industry structure resulting from the need to meet the demands of travellers and shippers.

Following the introduction of the new legislation, the economy entered a recession which reduced the demand for air services. This influenced the level of service provided by air carriers since the third quarter of 1989.

Scheduled passenger traffic increased as the economy improved after the 1981-82 recession and after the regulatory controls were relaxed in 1984. Between 1983 and 1990, scheduled passenger traffic in Canada rose by over 47 percent, with most of this increase occurring between 1983 and 1987. Passenger traffic began to drop in 1989 and has continued its decline into 1991. The demand for air service was also affected by the Gulf War, which caused fuel prices to rise and so, for a short while, raised air fares.

As a result of reduced demand carriers changed their service. The following sections describe the trends in service in the top twenty-five markets, the regional markets and in cargo service.

Top Twenty-Five Markets

As shown in Appendix 9.1, the number of flights (direct and indirect) between the top 25 city-pairs increased from 1987 to 1989 and has decreased since late 1989. The number of seats offered shows a similar trend. Compared to 1983, however, flights and seats offered in 1991 increased by 46 percent and 20 percent. By aircraft type, the number of jet flights offered in 1991 were 10 percent lower than 1987, but 22 percent higher than in 1983. Non-jet flights were 21 percent lower than in 1987 but 787 percent higher than in 1983. This indicates the growing competition in these markets from regional airlines, whose fleets utilize this type of aircraft.

Atlantic Provinces

A sample of 13 city-pairs in the Atlantic region (Appendix 9.2) shows that 23 percent more flights were offered in 1991 than in 1987, and 185 percent more than in 1983. There were 33 percent more non-jet flights in 1991 than in 1987, and 510 percent more than in 1983. The number of seats offered was fairly stable between 1991 and 1987, but in 1991 were 40 percent more than in 1983.

Ontario and Quebec

A sample of 16 city-pairs in these two provinces shows that since 1990 total flights have marginally declined, but are 15 percent greater than in 1987, and 158 percent more than in 1983. Since 1990, jet flights have also dropped 84 percent, and are 98 percent lower than in both 1987 and 1983. (This is due, in part, to the loss of Intair's services.) But non-jet flights in 1991 were 83 percent and 649 percent higher than in 1987 and 1983. Seats offered in 1991 were slightly less than in 1990, 21 percent lower than in 1987, but 5 percent higher than in 1983.

Western Provinces

A review of service between 22 city-pairs in the prairie provinces and British Columbia shows a marginal decrease in flights between 1990 and 1991. The number of flights in 1991 was however, 8 percent higher than in 1987, and 97 percent higher than in 1983. Since 1990, regional carriers have offered 11 percent more non-jet flights. This is an increase of 55 percent and 780 percent over 1987 and 1983. Similar to other regions, from 1990 to 1991, jet flights decreased 54 percent. The number of seats offered in 1991 dropped by 17 percent from 1990, by 26 percent from 1987 and were 13 percent less than in 1983.

Northern Air Services

The number of flights between 60 northern city-pairs (i.e. routes to, from, or within the north) dropped by 9 percent between 1990 and 1991. This was, however, an increase of 18 percent over 1987, and 111 percent over 1983. Seat capacity in 1991 was also 3 percent less than 1990. Again, however, 22 percent more seats were offered than in 1987, and 53 percent more than in 1983. By aircraft type, jet flights were down 2 percent from 1990. Non-jet flights decreased 14 percent. The north did, however, have 15 percent more jet flights than in 1987, and 12 percent more than in 1983. Similarly, non-jet flights were 21 percent higher than in 1987, and 630 percent higher than in 1983.

Cargo

The trend in cargo tonnage since 1988 is shown in Appendix 9.7. Cargo tonnages increased from 1988 to 1990 and declined somewhat in 1991. Although some improvement has been noted, most respondents to the Agency's surveys, carried out for the Annual Reviews, report little change in service. Cargo service is especially important to northern and remote communities. The expansion of regional carriers has improved links to southern markets.

Summary

When compared to the years before 1988, service to travellers and shippers has improved, despite the recent drop in demand for service during the recession. There is more competition in both southern and northern Canada, as shown by increased service in all markets and an increase in the number of routes served by two or more carriers since 1988, as shown in Appendix 9.7.

The two large carriers - Air Canada and Canadi*n - are suffering short-term difficulties due to reduced demand on high volume routes and long haul routes, and have had to deal with excess capacity by reducing service on some routes. But more flights and seats are offered than during 1983 to 1987, when the economy was strong, giving travellers more choice and flexibility. Although some communities lost jet services provided by major carrier, usually it was replaced by higher frequency turboprop and/or smaller jet services provided by regional affiliates of the large carriers and local "niche" carriers.

Using more non-jet service, affiliates of the major carriers continue to expand their service by taking over routes from major carriers, and by extending service to new "local" markets. The expansion of regional carriers has also been effective in linking northern and remote communities to the networks of major carriers.

FARES

One measure of the level of airfares is the average revenue carriers gain per passenger kilometre flown: in other words "yield". Appendix 9.3 tracks yield since 1986, in constant dollars, for the two large carriers.

Since 1988, this measure has shown stable yield, but it has decreased since 1987. This demonstrates how competition and the recession have affected the industry.

Statistics Canada's "Fare Basis Survey" reports an increase in both the economy fare index (including business class) and the discount fare index for domestic scheduled services operated by Level I carriers between 1986 and 1990. Appendix 9.4 shows the economy fare index to be higher than the Consumer Price Index (CPI) over the same period. Comparison with the CPI, however, does not take into account the increased use of discount fares since 1983.

Appendix 9.5 shows a steady increase in the use of discount fares since 1983. Discounts are now available on most routes, in both the south and the north and may be as much as 50 percent less than economy or basic fares. On both high-density and popular long-haul routes, carriers use discounts to fill seats and to compete. But discounts have been higher on the latter because charter operators also compete on these routes.

In the second quarter of 1991, over 64 percent of passengers on domestic flights in southern Canada travelled on discount air fares, the highest second quarter percentage reported since the survey was started in 1983. This figure results from Air Canada's and Canadi*n's seat sale strategy. This is a rise of 16 percent and 44 percent over the same period in 1987 and 1983 and is exceeded only by the 69 percent figure reported during the third quarter of 1990. (Usually companies discount fares most during the third quarter).

Similarly, in the second quarter of 1991, 42 percent of passengers carried on flights to, from, or within northern Canada travelled on discount air fares. This is an increase of 6 percent over 1987 and 35 percent over 1983.

Increased competition, resulting in more widespread use of discount fares, has curbed increases in air fares. Both economy and discount airfares have increased since 1987 but, as shown in Appendix 9.1, average fares (in constant dollars) have been fairly stable since 1987. Average fares in 1991 were only 6 percent higher than in 1987 due to the increased use of discount fares since 1987.

INDUSTRY STRUCTURE

Air services are dominated by two large carriers - Air Canada and Canadi*n - who now provide extensive route networks using affiliated regional carriers . In the early 1980's the air industry had prescribed roles for carriers. Smaller companies served as collectors and distributors for regional and national carriers. Since the mid-1980's this has been replaced by two networks linked to the larger carriers. These networks have grown through purchases of independent carriers, mergers and alliances. This allowed airlines to link national, regional and local flights and has produced two competitive networks.

In 1989, the recession cut demand and the Gulf war raised oil prices, squeezing the two large carriers' revenues. Faced with overcapacity, they were forced to reorganize service, lay off employees and offer widespread discounts in fares. The slumping economy forced large airlines to accelerate the transfer of service on most low density routes, which began in the mid-1980's, to their regional affiliates. As a result, domestic capacity by sector has changed. As shown in Appendix 9.6, regional affiliates increased their share of seats from 26 percent in 1988 to 36 percent in 1991. A similar trend has occurred in the growth of the regional affiliates' share of revenue. Regional carriers have acquired routes previously served by large carriers, and expanded to include local services. This has lead to improved service on smaller feeder routes.

The new competitive regime has also affected the independent sector, in particular charter services. In 1987 and 1988 many new charter services started up. By 1990, the recession and increased competition forced six charter services into bankruptcy. Despite the closing of several charter services, charter capacity remains greater than was available to tour operators in the mid-1980's.

In the scheduled sector, with the demise of Intair and City Express, two major independent services remain - Air Inuit and First Air. Others have been absorbed into the affiliates of the two large air carriers.

Overall, as a result of increased competition, licensed domestic air carriers and domestic licences issued have steadily increased. The trends in licences issued are shown in Appendix 9.7.

NORTHERN AND REMOTE REGULATIONS

The *NTA, 1987* kept some regulatory control over northern and remote air services because air service markets are fragile in these regions. This control covers market entry, complaints against unreasonable fares and certain licence restrictions. Appendix 9.8 shows the area of Canada covered by these controls.

In the south the Agency must issue a licence to a "fit" applicant. In the north a fit applicant can also obtain a licence to operate a service, but any person or group may object to the proposed licence. The onus of proving that the licence would cause a "significant decrease or instability" in service rests with the objector.

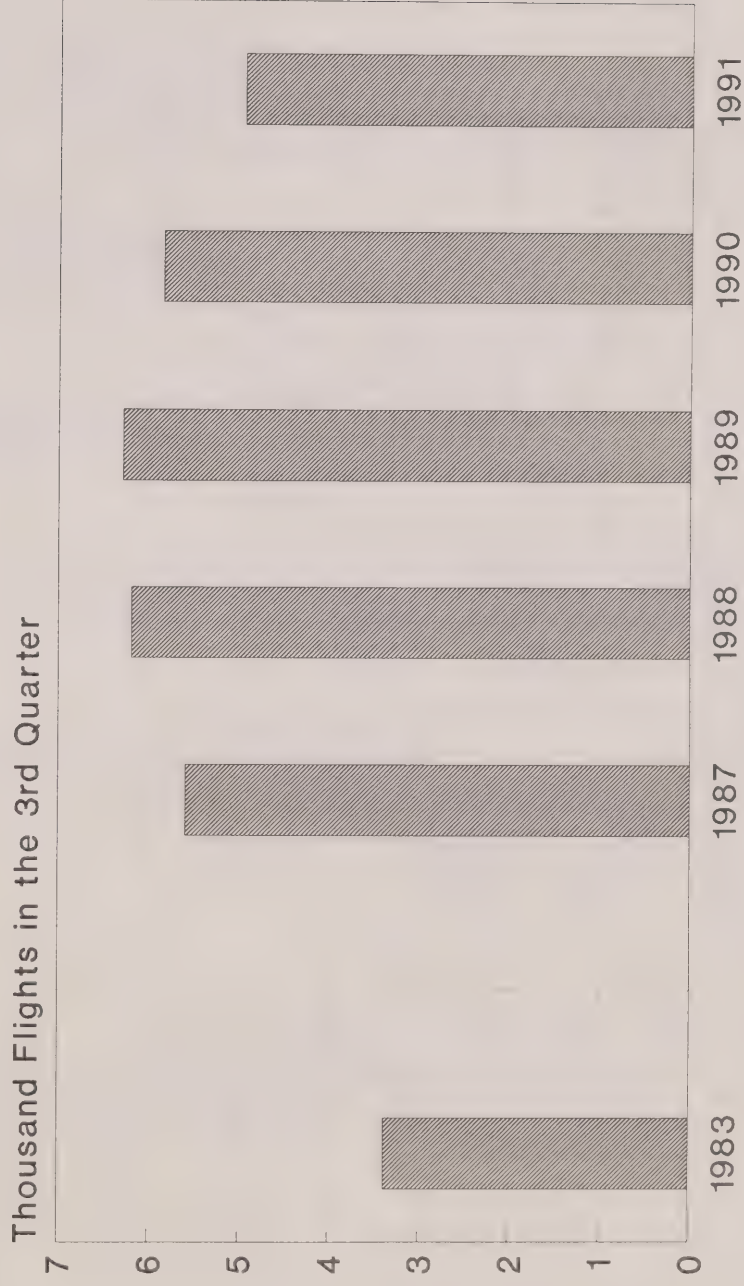
Since 1988, 209 objections to licence applications have been filed and in two cases the Agency has denied the licence. The Agency surveys, carried out for the Annual Reviews, have not identified any consensus against this reverse-onus process. Indeed, about 70 percent of those surveyed offered no opinion on the processes effectiveness. Similarly, 50 percent of those surveyed offered no opinion as to whether the process should be retained and 40 percent stated that it should be retained.

Since 1988, five complaints about unreasonable fares have been filed with the Agency. In all cases, the Agency found the fares to be reasonable. The Agency surveys have also identified support for retention of this provision.

Top Twenty-Five Canadian City-Pair Markets

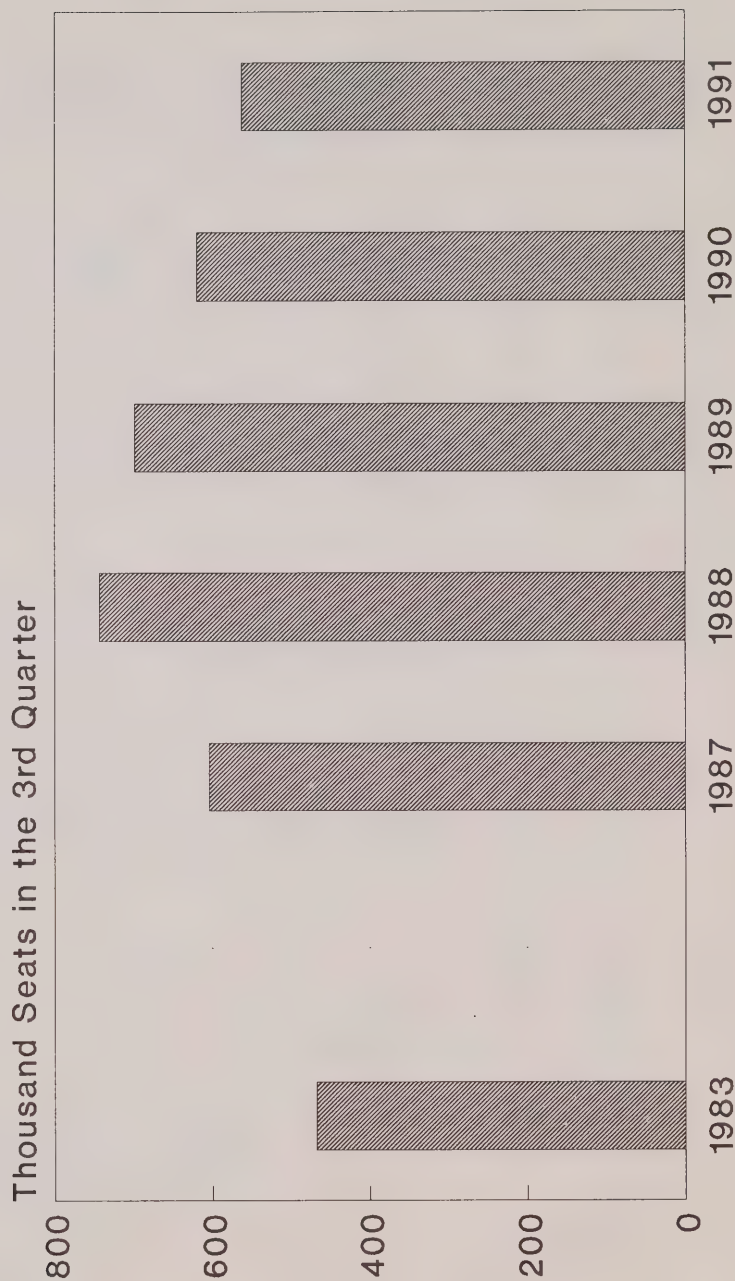
Year	Number of Weekly Scheduled:		Average Fare Constant 1991 Dollars
	Flights 3rd Quarter	Seats 3rd Quarter	
1983	3,386	467,735	-
1987	5,594	604,292	177.42
1988	6,188	743,013	158.29
1989	6,286	698,550	165.93
1990	5,845	619,550	180.68
1991	4,953	562,030	188.77

Weekly Scheduled Flights in the Top Twenty-Five Canadian Markets



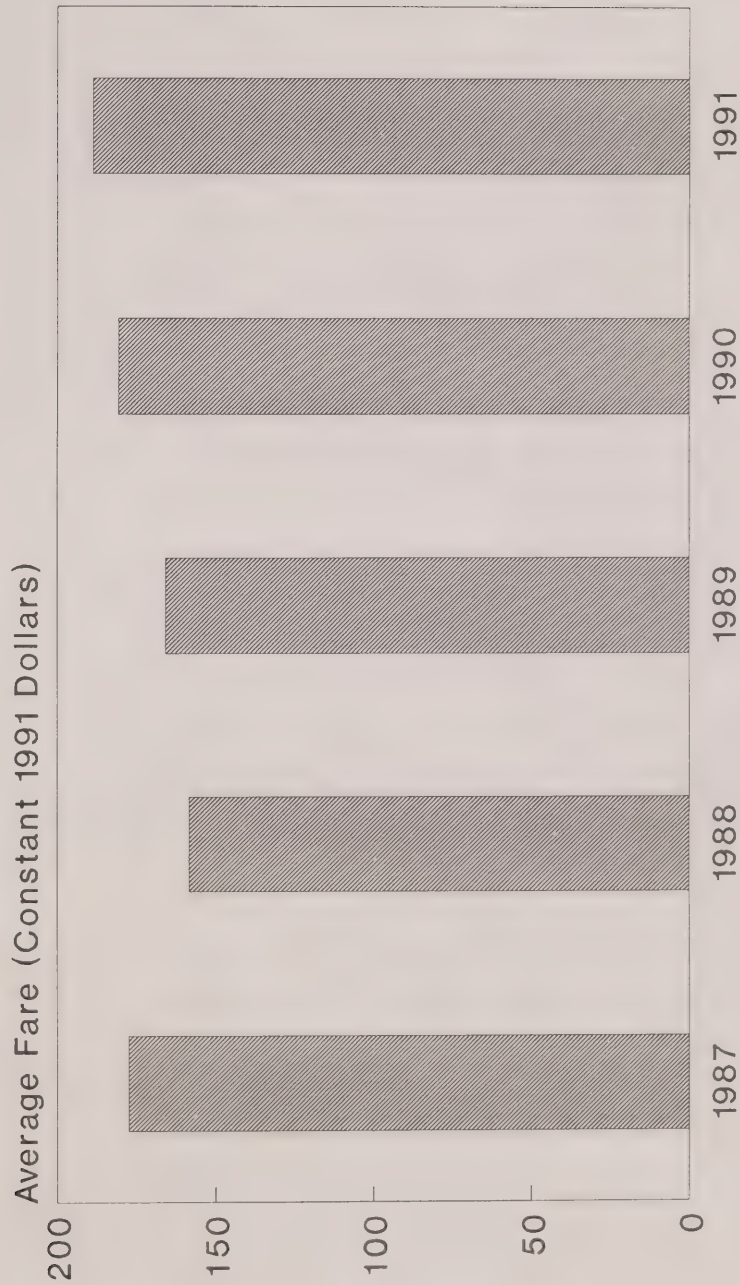
Comprehensive Review Staff Working Group
National Transportation Agency of Canada
Source: Agency statistics

Weekly Scheduled Seats in the Top Twenty-Five Canadian Markets



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National Transportation Agency of Canada
Source: Agency statistics

Average Air Fares for the Top Twenty-Five Canadian Markets



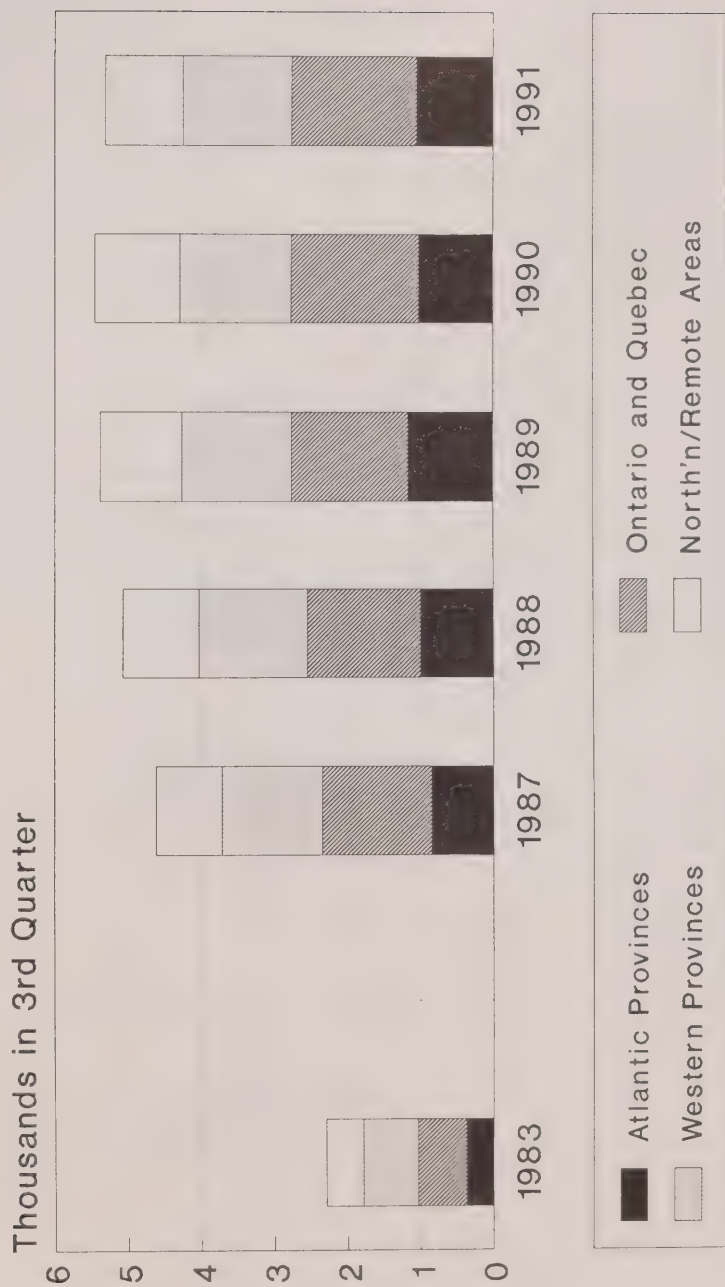
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Source: Agency statistics

Weekly Scheduled Flights and Seats in Canadian Regional Markets

	Year	Atlantic Provinces	Ontario and Quebec	Western Provinces	Northern and Remote Areas	Total
Flights 3rd Qtr.	1983	368	667	753	501	2,289
	1987	852	1,495	1,368	895	4,610
	1988	1,002	1,544	1,487	1,032	5,065
	1989	1,169	1,600	1,495	1,109	5,373
	1990	1,025	1,752	1,517	1,161	5,455
	1991	1,049	1,723	1,481	1,055	5,308
Seats 3rd Qtr.	1983	32,474	57,014	77,758	46,016	213,262
	1987	45,444	75,714	92,083	57,892	271,133
	1988	48,244	74,577	93,658	65,674	282,153
	1989	52,319	67,830	85,051	71,338	276,538
	1990	48,070	64,054	81,992	72,628	266,744
	1991	45,624	60,079	68,000	70,616	244,319

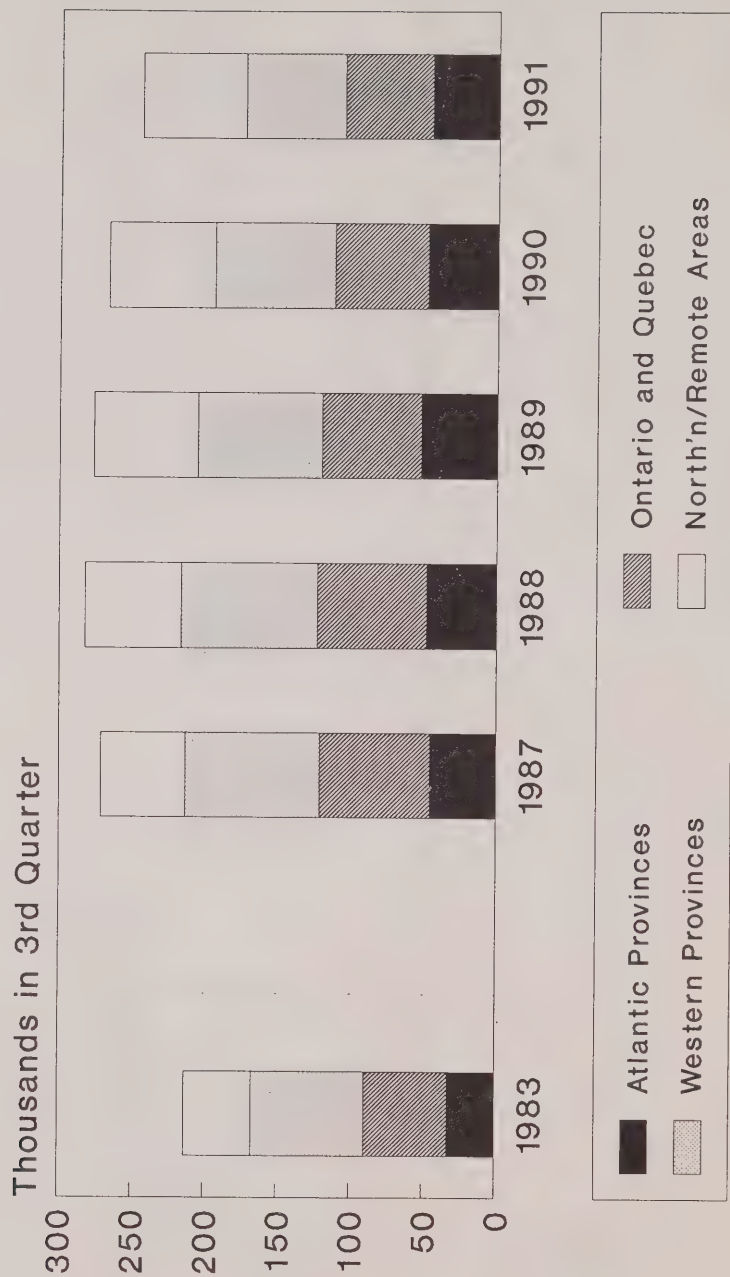
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Source: Agency statistics

Weekly Scheduled Flights in Canadian Regional Markets



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 Source: Agency statistics

Weekly Scheduled Seats in Canadian Regional Markets

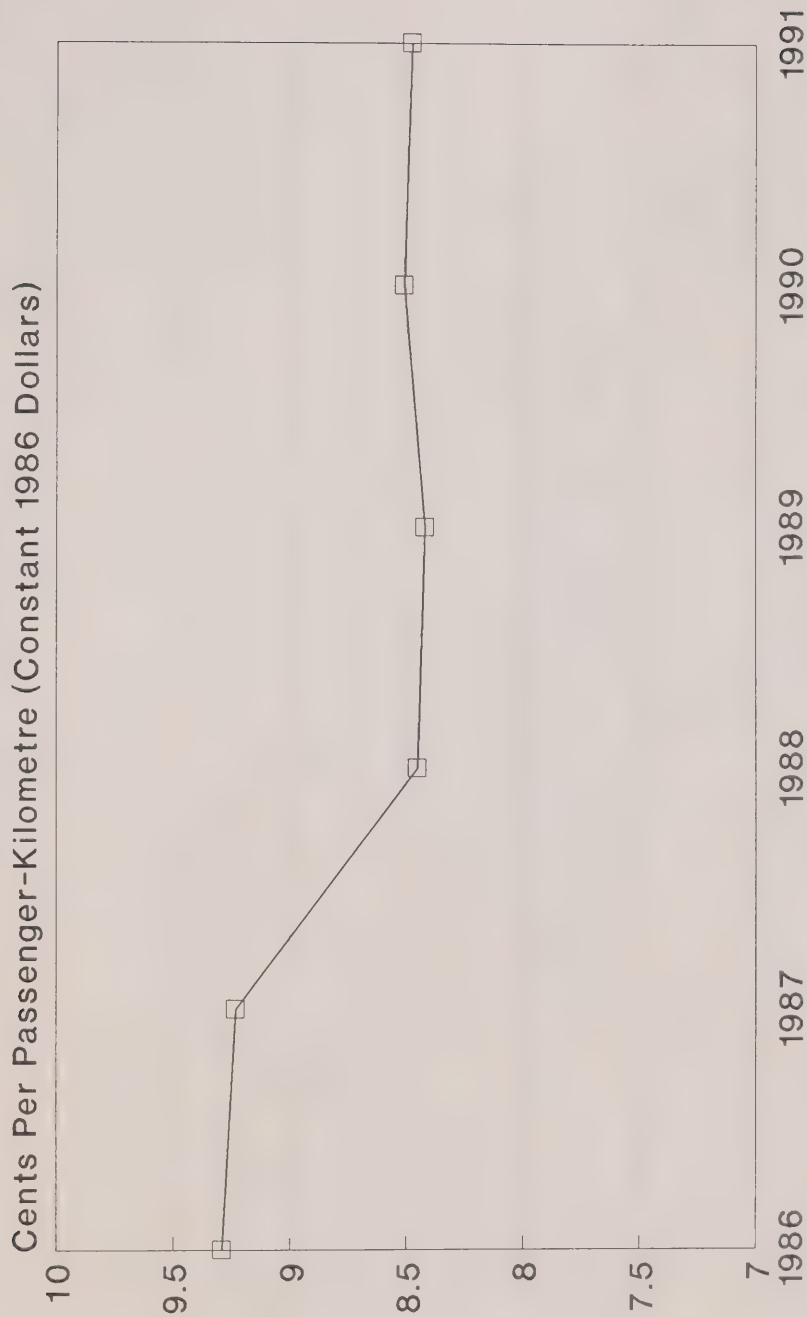


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National Transportation Agency of Canada
Source: Agency statistics

Yields: Air Canada and PWA Corp.

Year	Cents per Passenger Kilometre (constant 1986 dollars)
1986	9.29
1987	9.23
1988	8.45
1989	8.42
1990	8.51
1991	8.48

Yields: Air Canada and PWA Corp.



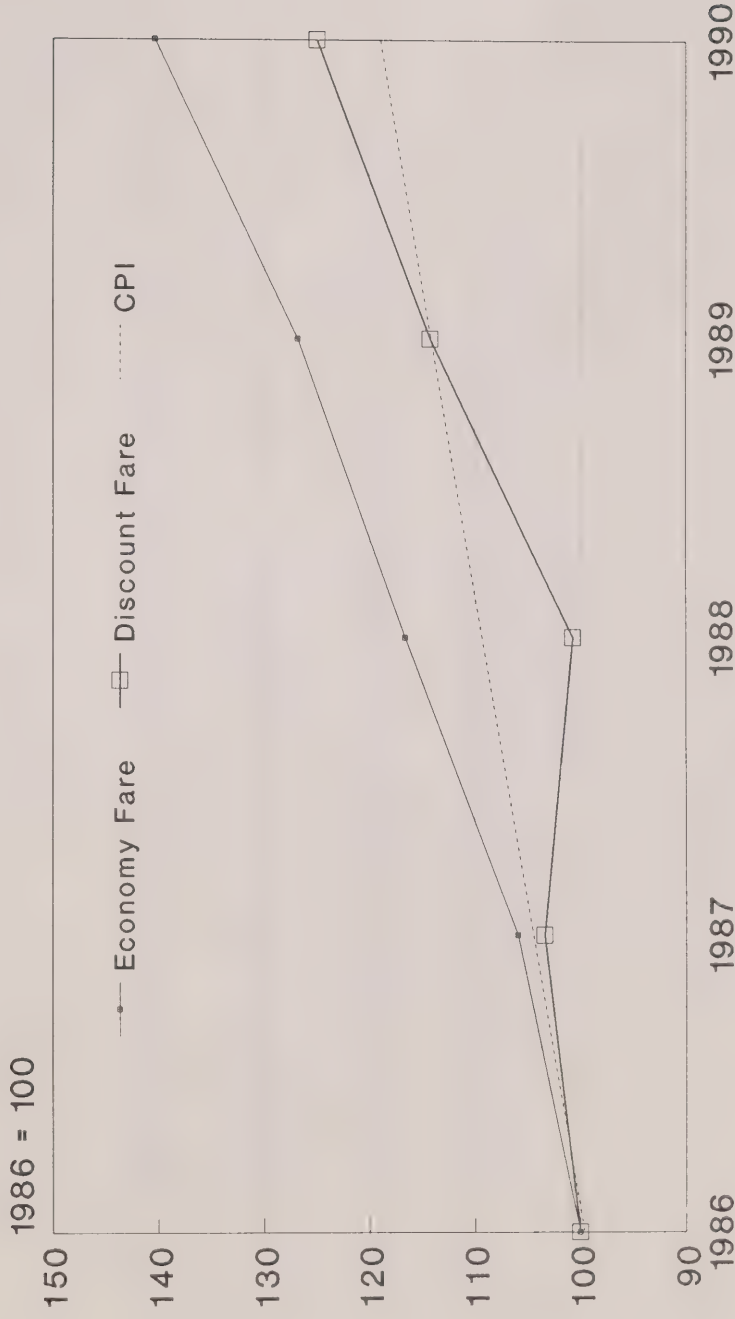
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 National Transportation Agency of Canada
 Source: Air Canada and PWA Corp.

Fare Index vs. Consumer Price Index on Southern Canadian Routes

Year	1986 = 100		
	Economy Fare	Discount Fare	CPI
1986	100.0	100.0	100.0
1987	105.9	103.4	104.4
1988	116.6	100.7	108.6
1989	126.8	114.2	114.0
1990	140.4	125.0	119.5

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Source: Statistics Canada

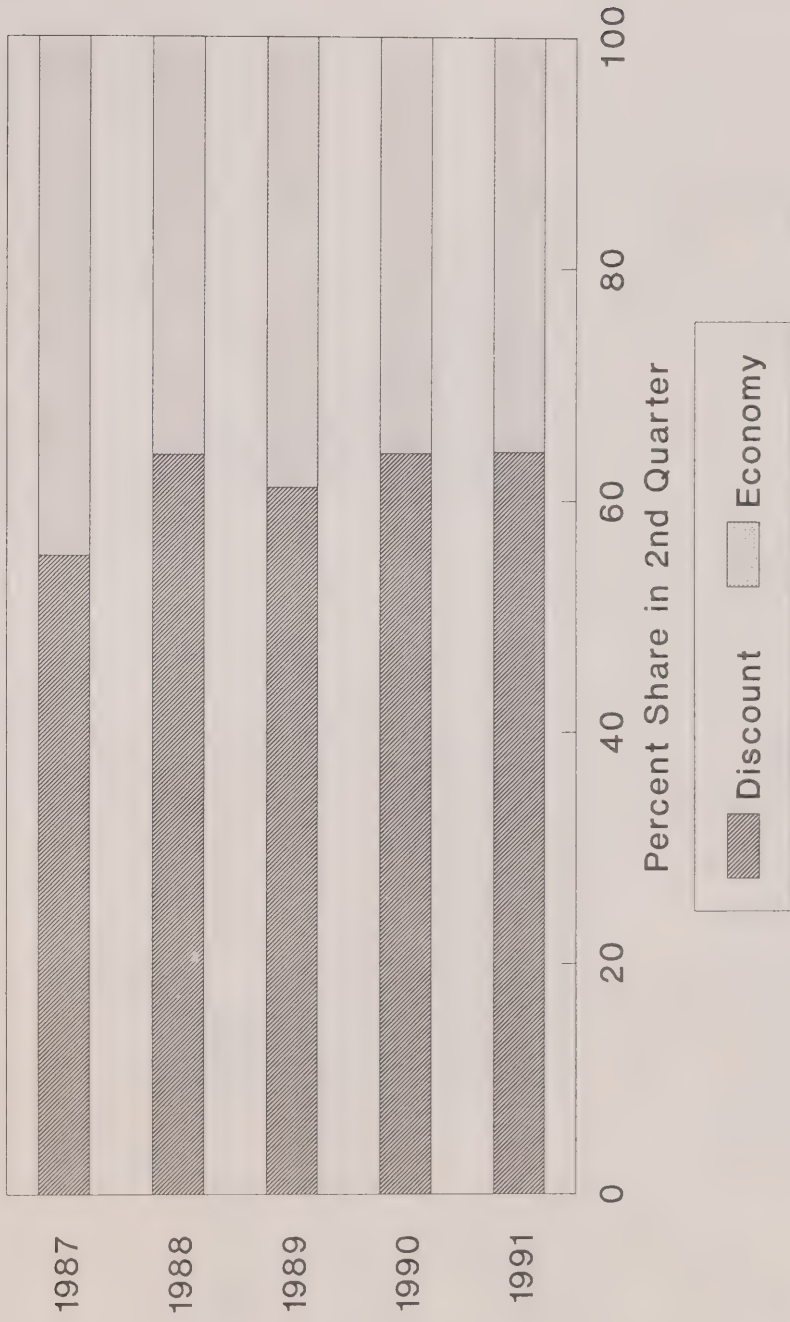
Fare Index vs. Consumer Price Index on Southern Canadian Routes



Discount vs. Economy Fare Usage

Year	Percent Share in 2nd Quarter	
	Discount Fare %	Economy Fare %
1987	55.3	44.7
1988	64.0	36.0
1989	61.2	38.8
1990	64.1	35.9
1991	64.2	35.8

Discount vs. Economy Fare Usage

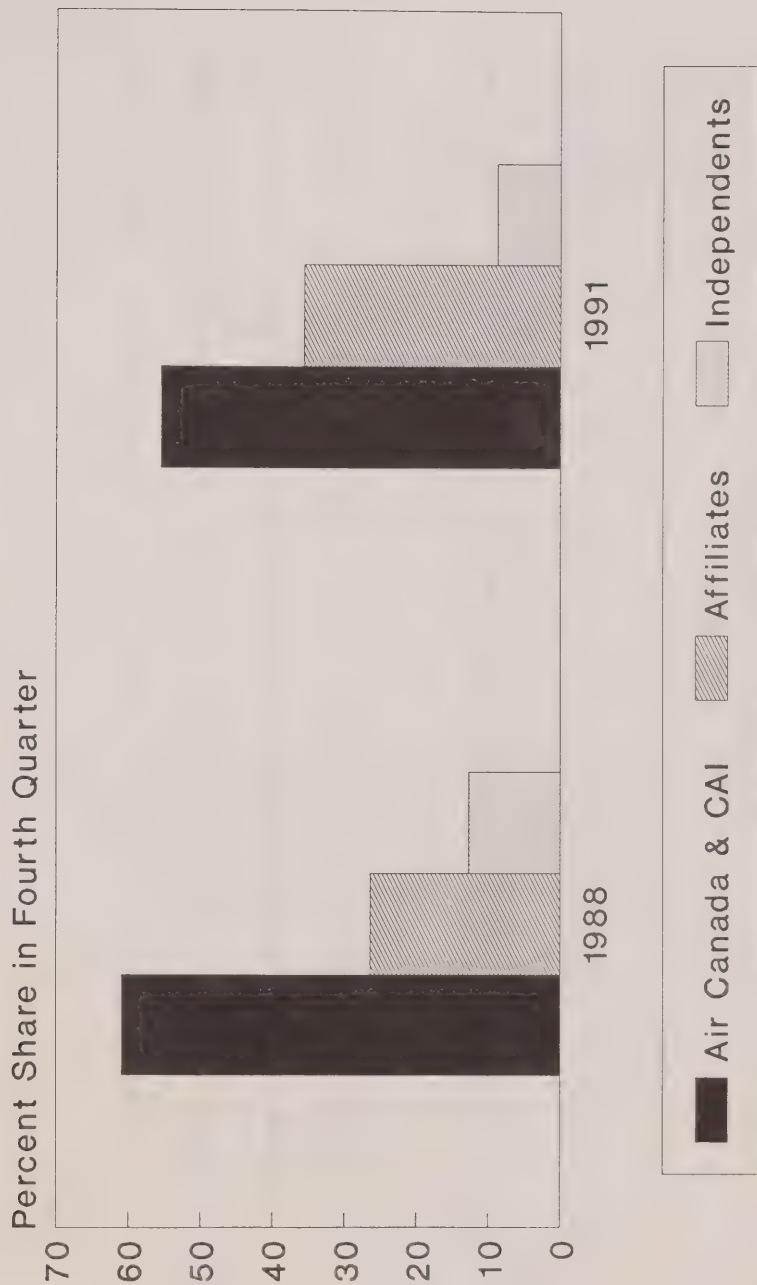


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 Source: Agency statistics

Share of Total Weekly Seats by Sector

Year	Percent Share in 4th Quarter		
	Air Canada and CAI %	Affiliates %	Independents %
1988	60.9	26.4	12.7
1991	55.5	35.7	8.8

Share of the Total Weekly Seats by Sector

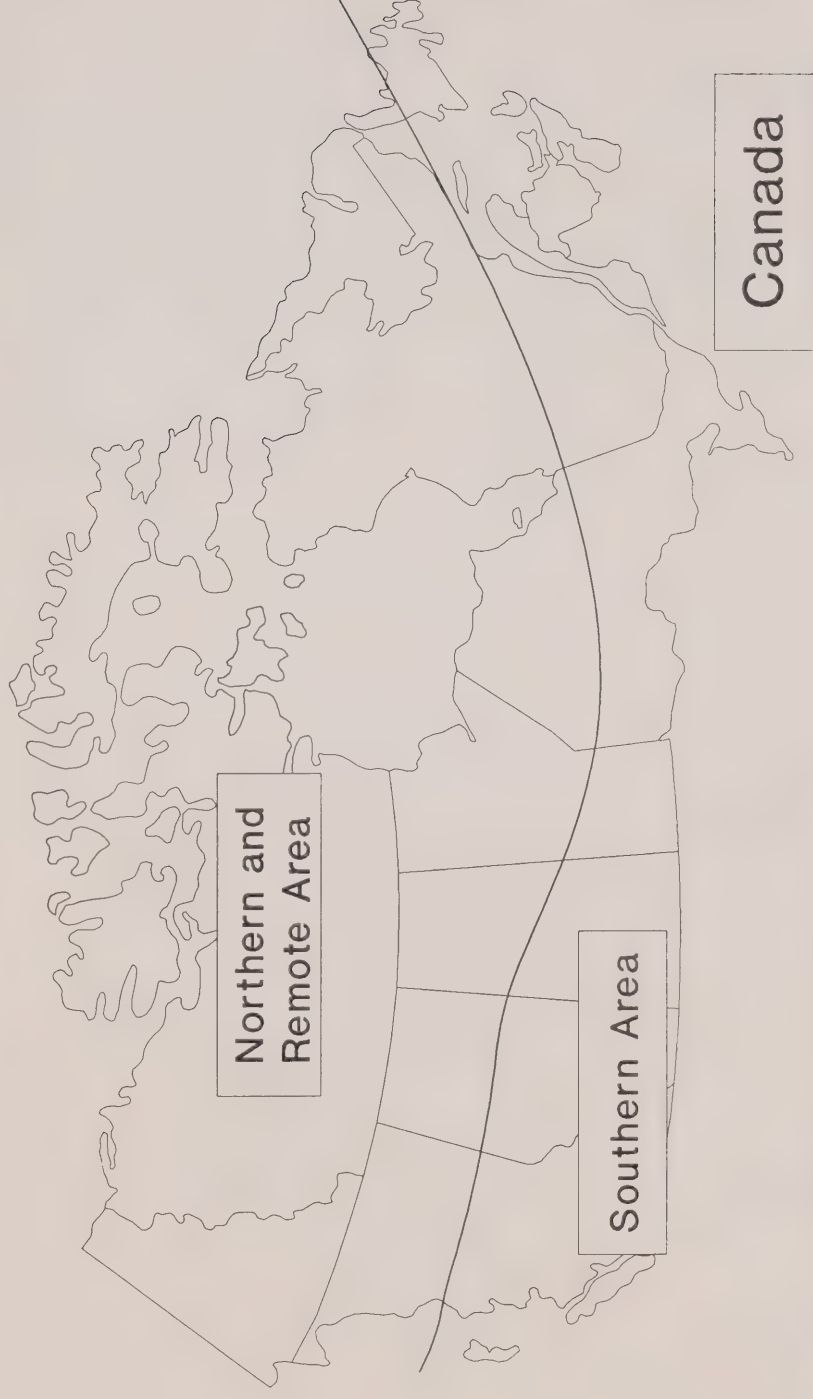


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National Transportation Agency of Canada
Source: Transport Canada

Other Air Statistics

Year	Licenses Held in Canada	Routes in Canada Served by Two or More Carriers %	Cargo Handled at Canadian Airports (000,000 kg)
1983	-	16.6	-
1988	1,858	23.2	620
1989	2,012	28.8	714
1990	2,198	30.8	722
1991	2,430	28.4	684

Delineation of Northern and Southern Routes for License Purposes



Comprehensive Review Staff Working Group
National Transportation Agency of Canada
Source: Agency statistics

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